market shares of all the participants in a particular market. As a preliminary mechanism, HHI generally categorizes markets into three levels of concentration:

Unconcentrated -- HHI below 1000
Moderately Concentrated -- HHI between 1000 and 1800
Highly Concentrated -- HHI above 1800

TCG argues that LEC pricing flexibility should be triggered when the HHI index for a given market falls below 1800.[3]

TCG's reference to the Department of Justice's Merger Guidelines ("Guidelines") suggests a fundamental misunderstanding of the Guidelines' approach to the measurement of market power. Nowhere do the Guidelines support TCG's bald conclusion that "[a] highly concentrated market is viewed as giving its participants the ability to raise prices without customers having the ability to shift to a competitive provider."[4] Rather, the Guidelines use the HHI merely "as an aid to the interpretation of market data."[5] Upon completion of the HHI, the Guidelines require the use of other critical steps, including the assessment of entry conditions, competitive effects, and efficiencies.[6] Only after consideration of all relevant market conditions do the Guidelines attempt to draw any conclusion about the ability of parties to

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[3] TCG at 17-18.

[4] Id. at 18.

[5] Guidelines at § 1.5.

[6] Id. at §§ 2-5.

exercise market power. The HHI viewed in isolation as TCG proposes is relatively meaningless.[7]

TCG's misunderstanding of the Guidelines is clear from its approach to market definition. TCG asserts that "the relevant market for assessing the degree of competition should be the total regulated market currently served by the LECs, which would include access services, local services, intraLATA toll, and associated (tied) services (such as directory assistance, directory publishing.)."[8] The proposal for a super-aggregated market definition obviously does not derive from the application of the supply and demand elasticity considerations that the Guidelines (and all other reasoned approaches to market definition) consider imperative.[9] The Guidelines define a product market as:

> a product or group of products such that a hypothetical profit-maximizing firm that was the only present and

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[7]It is interesting to consider how the application of TCG's misguided use of the HHI would have affected the Commission's regulation of the interexchange market. For example, according to the Commission's Report, Long Distance Market Shares: Fourth Quarter 1993, rel. Apr. 15, 1994, at 12, AT&T currently has a market share of 60 percent of the interstate toll market, MCI 16 percent, and Sprint 10 percent. The HHI for this market is over 4016! Thus, using TCG's proposal, AT&T's market share would need to be cut by more than half -- to less than 30 percent -- before TCG would grant any pricing flexibility to AT&T!

[8]TCG at 22-23. See also AT&T at 16-18.

[9]Guidelines at §§ 1.0-1.3. This issue is further discussed by Schmalensee and Taylor in their attachment to the USTA Reply Comments. They note that "market power can only be assessed in the context of an economic market: the ability of a multi-product firm to raise the price of shoes cannot affect its ability to raise the price of potato chips." USTA Reply at Attachment Market Analysis and Pricing Flexibility for Interstate Access Services, by Richard Schmalensee and William Taylor, at 3 ("Schmalensee/Taylor Attachment").

> future seller of those products . . . likely would impose at least a "small but significant and non-transitory" increase in price.[10]

The fact that U S WEST, as a multi-product firm, offers both local exchange and interstate access services says nothing about U S WEST's ability to sustain a supracompetitive price (i.e., our market power) in the interstate access market. Nor does our offering of local exchange services say anything about our ability to sustain below cost pricing of interstate access services through cross-subsidization. Such cross-subsidization concerns can be addressed by removing interstate access services offered in competitive wire centers from price cap regulation and removing the ability to increase rates for other services through the elimination of the sharing and lower-end adjustment mechanism.

TCG further deviates from the Guidelines by suggesting the Commission ignore the potential competition confronting the LECs.[11] This proposal is completely at odds with the Guidelines' express inclusion of both committed and uncommitted entrants as crucial factors in the market power analysis.[12] Indeed, the Guidelines require the inclusion of uncommitted entrants in the defined market in order to arrive at an accurate HHI.[13]

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[10]Guidelines at § 1.11.

[11]TCG at 20.

[12]Guidelines at §§ 1.32 and 3.0.

[13]Id. at § 1.32.

Finally, TCG purports that "competitor net revenues are the appropriate measure of competitor market share" for the Commission's purposes.[14] The Guidelines, on the other hand, show that relative capacity is the most appropriate unit of measure for access services.[15]

B. Time Warner

Time Warner's suggestion that LEC competition is "years, if not decades" off ignores market realities.[16] As U S WEST pointed out in its Comments, the sophisticated purchasers of access will readily accept alternatives, while less sophisticated consumers are accustomed to selecting among telecommunications providers, given their experience with long distance companies.[17] Further, the pace of technological change is quicker now than ever before, and developing competition will flourish more rapidly than with CPE and long distance.[18]

Time Warner also proposes, with no legal, economic, or regulatory precedent, that markets are not competitive unless challengers offer "equivalent services" and then "with the same degree of ubiquity" as incumbent LECs.[19] Time Warner fails to recognize that substitutability is a matter of degree. Moreover,

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[14]TCG at 23. See also Time Warner at 13 n.21.

[15]Guidelines at § 1.41.

[16]Time Warner at 12.

[17]U S WEST at Appendix 1 at 15-16.

[18]Id. at 12-14.

[19]Time Warner at 13-15.

it is not the proper role of regulation to subsidize new market entrants until their offerings are somehow "equal" to LECs'. Time Warner's approach runs counter both to accepted economic principles and to established antitrust law.

C. MFS

On a positive note, MFS acknowledges that "it is prudent to begin planning for a transition to competition."[20] This position is consistent with MFS' belief that "[l]ocal exchange competition is virtually certain to increase in the future.[21]

However, MFS' statement that it would be "unrealistic to declare a market 'competitive' before most customers have the ability to purchase competitive services" overstates the nature of supply substitution.[22] MFS misconstrues the effects of supply substitution on market power. The alternative source of supply need not be available to most customers to have a substantial impact on an incumbent's market power. Instead, the alternative source of supply need be available only to a sufficient number of customers (or a sufficient amount of demand from a more limited number of customers) so that if the incumbent prices in an anticompetitive manner the shift in demand to

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[20]MFS at 37.

[21]See In the Matter of the Application of MFS Intelenet of Washington, Inc., for an Order Authorizing the Registration of Applicant as a Telecommunications Company, filed with the Washington Utilities and Transportation Commission on May 13, 1994, Docket UT-940670, at Exhibit C (emphasis added).

[22]MFS at 45 (emphasis added).

competitive suppliers will be sufficient to defeat the anticompetitive increase.

The Commission has previously adopted the notion that the effects of supply substitution for a minority of the demand in a market can substantially reduce the market power of an incumbent. For example, the Commission considered the ability of competitors to absorb only 15 percent of AT&T's business day traffic to be sufficient to defeat anticompetitive behavior.[23]

D. The Commission Should Implement a Transition Mechanism Now

The Commission faces two threshold questions in this proceeding with regard to access reform -- "Will competition in specific interstate access markets be sufficient during the life of the next price cap plan to warrant the implementation of a transition mechanism now?" and, if so, "What trigger mechanism should the Commission use to determine whether a local exchange carrier retains market power within a specific interstate access market?"

U S WEST believes the answer to the first question is a resounding yes, as demonstrated in both U S WEST's and USTA's Comments in this proceeding. Given the rapid change in the interstate access markets, it is essential that the Commission rejects proposals to delay the implementation of a transition mechanism in the Price Cap Plan. As Professor Harris of the University of California at Berkeley notes:

[23] See U S WEST at Appendix 1 n.5.

> By adopting a policy framework that will facilitate and accommodate changing technological, competitive and market conditions, the Commission will be sending valuable signals to the investors, competitors and customers. In areas where LECs already face competition, LECs can request to change their classification immediately and be able to respond to competition. In addition, by establishing these self-adaptive mechanisms now, the Commission will reduce the degree of uncertainty and risk concerning the effects of increased future competition, giving competitors, potential entrants and customers the information they need to make long-term business decisions, such as long-lived capital investments and long-term supply contracts. Adoption of transition mechanisms can also help "fulfill the future." By adopting effective transition mechanisms now, the Commission would provide assurance that, as competition develops, LECs will be allowed increasing flexibility to respond and compete fairly.[24]

"What trigger mechanism should the Commission use to determine whether a local exchange carrier retains market power within a specific interstate access market?" U S WEST believes the answer to this question is addressability.

As discussed above, the Commission should reject proposals to base triggers on market shares in broad geographic areas, or on a combination of adjacent markets. Instead, the Commission should adopt a trigger mechanism that is: specific to the interstate access market; forward-looking; an accepted measure of the local exchange carrier's market power within the interstate access market; and is measurable through data readily obtainable by the Commission. U S WEST believes the only trigger mechanism that meets these criteria is addressability.

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[24]Reply Comments of USTA filed simultaneously herewith ("USTA Reply") at Attachment, Reply Report on LEC Price Cap Reforms: United States Telephone Association, by Professor Robert G. Harris, University of California, Berkeley, and Law & Economics Consulting Group, Inc., June 24, 1994 ("Harris Report"), at 4-5.

The advantages of addressability are further discussed in the USTA Reply in this proceeding,[25] as well as in the U S WEST Comments.[26] Further elaboration on the concept of addressability as a trigger mechanism is provided in attachments to the USTA Reply Comments.[27]

[25]USTA Reply at 36-40.

[26]U S WEST at 83-85.

[27]Schmalensee/Taylor Attachment at 16-22; Harris Report at 3-5.

Attachment 2

FCC Report 43-06
ARMIS SEMIANNUAL SERVICE QUALITY REPORT

Submission 1
Table I

Company: U S WEST Communications
Report Date: 3/31/94
Report Period: July - December 1993

	ARIZONA Res.	ARIZONA Bus.	IOWA Res.	IOWA Bus.
No. of Resp.	1142	1125	1120	1105
% Satisfied	91%	89%	93%	89%

	COLORADO Res.	COLORADO Bus.	MINNESOTA Res.	MINNESOTA Bus.
No. of Resp.	1176	1122	1145	1128
% Satisfied	89%	83%	93%	91%

	IDAHO Res.	IDAHO Bus.	NEBRASKA Res.	NEBRASKA Bus.
No. of Resp.	1125	1127	1134	1130
% Satisfied	94%	91%	92%	91%

	MONTANA Res.	MONTANA Bus.	NORTH DAKOTA Res.	NORTH DAKOTA Bus.
No. of Resp.	1126	1123	1129	1131
% Satisfied	93%	87%	95%	92%

	NEW MEXICO Res.	NEW MEXICO Bus.	SOUTH DAKOTA Res.	SOUTH DAKOTA Bus.
No. of Resp.	1139	1125	1118	1128
% Satisfied	90%	91%	94%	92%

	UTAH Res.	UTAH Bus.	OREGON Res.	OREGON Bus.
No. of Resp.	1131	1128	1129	1124
% Satisfied	92%	89%	92%	90%

	WYOMING Res.	WYOMING Bus.	WASHINGTON Res.	WASHINGTON Bus.
No. of Resp.	1123	1131	1141	1144
% Satisfied	92%	88%	92%	90%

CERTIFICATE OF SERVICE

I, Kelseau Powe, Jr., do hereby certify that on this 29th day of June, 1994, I have caused a copy of the foregoing **REPLY COMMENTS OF U S WEST COMMUNICATIONS, INC.** to be served via first-class United States Mail, postage prepaid, upon the persons listed on the attached service list.

Kelseau Powe, Jr.

***Via Hand-Delivery**

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